TL-N-853-89

Internal Revenue Service
memorandum

CC:TL:Br3
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date: DEC 30 1988

to: Regional Director of Appeals, Central Region C:RDA

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Technical Advice: [redacted]
Medical Corporation Money Purchase Pension and Profit Sharing Plans

You have requested that we provide technical assistance as to the applications for determination pending in regard to the above plans. Specifically, it has been requested that we assess the litigation hazards with respect to the proposed adverse determinations.

ISSUE

Whether the subject plans should be retroactively qualified back to the effective date for the Employee Retirement Income Security Act of 1974 ("ERISA").

FACTS

The taxpayer, [redacted], originally established a Money Purchase Pension Plan and a Profit Sharing Plan, effective [redacted]. Both plans employ a fiscal year ending October 31. A favorable determination letter as to initial qualification was not obtained for either plan. In addition, the plans were not amended to comply with ERISA until March of 1986 when they were restated in compliance with I.R.C. sec. 401(a). On March 27, 1986, applications for determination, together with applications for determination upon termination, were submitted for both plans.

The District has made a proposed determination that neither plan is qualified for plan years ending on and after January 1, 1975. See, e.g., letter of District Director, dated March 23, 1988. At the same time, however, the field acknowledges that the restated plans satisfy (in form) the qualification requirements for plan years beginning on and after January 1, 1984. See, e.g., id. (Attachment A, at 2). Therefore, unless there are operational problems (which, so far, none has been raised), the plans are unquestionably qualified for plan years beginning on and after November 1, 1984.

The taxpayer argues that this is an appropriate case for the I.R.S. to retroactively extend the remedial amendment period for the subject applications under I.R.C. sec. 401(b), as permitted in Treas. Reg. sec. 1.401(b)-1(e), back to the effective date of ERISA. See letter of [redacted], dated [redacted] In support of this claim, the taxpayer's representative makes the following representations: (1) The plans have operated in compliance with ERISA; (2) the taxpayer reasonably believed that applications for determination with respect to both plans were submitted to the I.R.S. in [redacted] and (3) it was not discovered that applications had not been submitted until after certain relevant deadlines had passed. See id., at 3-4. However, in a recently submitted statement of the trustee, she indicates that she was aware that an application had never been submitted. See statement of [redacted], dated [redacted] at 2 & attached letter, dated [redacted], at 2.

Analysis

In arguing that the subject plans should be retroactively qualified back to the effective date of ERISA, taxpayer looks to sec. 1.401(b)-1(e). This provision gives the Commissioner authority to "allow a particular plan to be amended after the expiration of its remedial amendment period... ." Id. It also directs that in making this determination, the following factors shall be considered: Hardship to the employer, the interests of participants, and the interests of the Service. [1] See id. Because this regulation confers discretionary authority on the Commissioner, the exercise of such will ordinarily be subject to reversal by the courts only for an abuse of discretion. See, e.g., Oakton Distributors, Inc. v. Commissioner, 73 T.C. 182, 188 (1979). In this case, it is our view that the proposed refusal to allow the plans to retroactive qualify under sec. 1.401(b)-1(e) will not, in the circumstances involved, be found to be an abuse of discretion.

First, the request for extension came some 10 years after the remedial amendment period ended for amending the plans to comply with ERISA. See sec. 1.401(b)-1(c)(1)(iii) & (2). Given the length of time involved, it is unlikely that the courts would find it to be an abuse of discretion for the Service to consider the application as not having been submitted within a reasonable time as the regulations require. See Oakton Distributors, Inc.,

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1 Moreover, in order for this provision to apply, a request for extension must be submitted to the District Director in a timely fashion. See id.

at 189 (not arbitrary and capricious to regard a period of more than 3 years as unreasonable).

Second, it appears that it would also not be an abuse of discretion for the Service to deny the request on its merits. Oakton Distributors, Inc. is dispositive here. In that case, as here, the taxpayer relied primarily on the adverse consequences to the employer and employees resulting from disqualification to support its request. See id., at 189; [redacted] Letter, dated [redacted], at 3-4. In rejecting the taxpayer's claim that the I.R.S. abused its discretion in refusing to extend the sec. 401(b) period in these circumstances, the court observed that:

> petitioner has cited no hardships other than those which ordinarily flow from loss of qualified status for plans. Furthermore, to accept petitioner's position would ... be tantamount to requiring that the Internal Revenue Service extend the remedial amendment period in any or every case in which it discovers a defect in the original plan while ruling on a request for determination that plan amendments qualify ... .

Id., at 189-90. This is essentially the situation here, and therefore, the Service would be amply justified in denying the requested extension on substantive grounds as well.

This does not end the inquiry, however, as retroactive correction has been allowed by the courts even where sec. 401(b) is inapplicable. See, e.g., Oakton Distributors, Inc., at 190 and cases cited therein. Such relief is available where two conditions are met: (1) The objectionable provisions were never put into operation, and (2) the employer exercised reasonable diligence in attempting to obtain a favorable determination letter from the Service. See, e.g., Bolinger v. Commissioner, 77 T.C. 1353, 1360 (1981). In regard to the instant case, it is unrefuted that the subject plans operated in compliance with ERISA throughout the period in question. Therefore, there is no basis in the record for questioning whether the first condition has been satisfied here. With respect to the second requirement, however, it appears that reasonable diligence was not used, as the trustee was aware throughout that an application had not been submitted post-ERISA. See [redacted] statement, dated [redacted]. Moreover, even if it can be said that reasonable diligence was used, this would, at best, allow for qualification back to [redacted] -- the first year in which efforts were supposedly made to submit an application. In this regard, ERISA became applicable to existing plans (such as the ones involved here) as of the first plan year beginning after

December 31, 1975. See id., sec. 1017(b). And, the plans' remedial amendment period with respect to ERISA apparently ended in early 1978. See sec. 1.401(b)-1(c)(2)(i)(A). At the same time, the ERISA Non-Compliance Enforcement Program, which established a relief procedure for certain plans which were not timely amended to comply with that Act, is not applicable here because the subject plans did not have pre-ERISA determination letters. See Notice 80-7, 1980-1 C.B. 578. Consequently, even if it could be said that reasonable diligence was used, there is no basis for allowing retroactive correction back to the effective date of ERISA, as taxpayer requests.

Nevertheless, while we do not consider the hazards with respect to the substantive issue presented to be substantial, we believe that there are a number of practical considerations which warrant settling this matter (via a closing agreement) in favor of the taxpayer. The reasons for this recommendation are as follows. First, contributions were last made to the plans in [redacted]. As a result, the statute of limitations for the affected years of the employer has expired. Second, the employer apparently filed schedules P with the Forms 5500 since [redacted] [2] Therefore, the only taxable years of the trust which remain open are those in which the plan was unquestionable qualified (that is the years ending [redacted] and thereafter). Third, to the extent the plans are disqualified, it can be claimed that any participant's interest attributable to the nonqualified years was (to the extent vested) includible in income in those years and hence, not taxable at distribution. See I.R.C. sec. 402(b). And, of course, the taxable years in which the contributions were includible are now probably closed. Therefore, in order to avoid this potential whipsaw, we believe that the better course in this case is to accept the taxpayer's proposal that we treat the subject plans as qualified for all post-ERISA years. [3]

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[2] For pre-[redacted] plan years, the Service has announced that the Form 5550 will be treated as beginning the statute of limitations. See Announcement 80-45, 1980-15 I.R.B. 7.

[3] As part of this proposal, the taxpayer's representative stated that [redacted] will agree that she has no basis with respect to her interest in either plan. This, of course, will have to be memorialized in a closing agreement.

If you have any questions regarding the foregoing, please contact David Mustone of this Division at (FTS) 566-3407.

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